Untangling the Effects of Managerial Discretion: A Contingency Approach

Abstract

Strategic management scholars have long considered when and to what extent managers are able to influence their organisations. Though early scholars understood the role of constraints in the ability of managers to undertake certain actions, it was Hambrick and Finkelstein's (1987) conceptualization of "managerial discretion" that sparked research on various factors that enhance or inhibit manager's ability to influence organizational outcomes such as firm performance (Wangrow et al., 2015). Since managers are hired to sustain and improve firm performance, it is critical to understand the factors that enable or constrain them to influence organizational outcomes.

Managerial discretion involves two distinct components – latitude of objectives and latitude of action (Shen and Cho, 2005). Latitude of objectives, based on Williamson (1963), refers to the freedom managers have in pursuing their own interests, whereas latitude of actions, popularized by Hambrick and Finkelstein (1987), refers to the range of strategic options managers have to affect organizational outcomes such as firm performance. Although certain studies on agency problems (Shleifer and Vishny, 1997) have highlighted latitude of objectives, the idea of latitude of actions has largely dominated the management discretion literature (Wangrow et al., 2015). However, these two components of managerial discretion operate in distinct ways (Shen & Cho, 2005). In this backdrop, my thesis focuses on untangling the effects of managerial discretion in terms of latitude of objectives and latitude of actions, to better understand the circumstances that make managers more inclined to act in the interests of stakeholders.

In order to do so, we use the transparency of the firm's corporate information environment as a mechanism that curbs managerial discretion as latitude of objectives. By facilitating quicker and more complete dissemination of firm-specific information,

transparency curbs latitude of objectives to align managers with stakeholders. Conversely, when the information environment is opaque, managers are free to pursue their own objectives without fear of detection. Managerial discretion arising from latitude of actions, on the other hand, shapes the degree or extent to which managers can influence organizational outcomes such as firm performance.

In the first essay, we study the relationship between managerial discretion and corporate social performance (CSP), examining the effects of both latitude of objectives and latitude of action. We find that a transparent corporate information environment, by revealing information about managers' actions, curbs managers' latitude of objectives thereby enhancing CSP while opaque environments reduce CSP. We also find that the above relationship is strengthened by factors that increase the managers' latitude of actions. In other words, while latitude of objectives shapes the direction of managerial influence on CSP, latitude of actions determines the magnitude of managerial influence on CSP.

In the second essay, we study the relationship between managerial ability and firm performance to understand contexts where managers with high ability use managerial discretion to enhance or impair firm performance. We find that managers with high ability enhance firm performance in transparent information environments when latitude of objectives is low while they impair firm performance in opaque information environments when latitude of objectives is high. We also find that the above relationship is strengthened by factors that increase managerial discretion with regard to the latitude of actions.

Overall, my thesis contributes to the managerial discretion literature by integrating both aspects of managerial discretion, latitude of objectives and latitude of actions, to provide a better understanding of how managers use their discretion in various contexts.

References

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